Report to the Legislative Assembly of the Northwest Territories Other Matters for the year ended March 31, 1989

AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

Ottawa, Ontario
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January 8, 1990

The Honourable Richard Nerysoo
Speaker of the Legislative Assembly
of the Northwest Territories
Legislative Assembly
Yellowknife, N.W.T.

Dear Mr. Nerysoo:

I hereby transmit a report to be laid before the Legislative Assembly in accordance with the provisions of section 30 of the Northwest Territories Act, R.S.C. 1985, c.N-22.

The report deals with "other matters" arising from my examination of the accounts and financial statements of the Government of the Northwest Territories for the year ended March 31, 1989 that, in my opinion, should be brought to the attention of the Legislative Assembly. The report also includes my recommendations and the related management responses.

Cordially yours,

Kenneth M. Dye, F.C.A.
Auditor General of Canada

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REPORT ON OTHER MATTERS
FOR THE YEAR ENDED MARCH 31, 1989

INTRODUCTION

We audited the accounts and financial statements of the Government of the Northwest Territories for the year ended March 31, 1989.

Our audit included reviews of certain operating, legislative and financial control systems and financial management practices, together with detailed tests where we considered them necessary.

This office also audited the following agencies of the Government and issued reports during the past year.

Audit	Year End	Reported to
Workers' Compensation Board	December 31, 1988	Minister
Northwest Territories Housing Corporation	March 31, 1989	Minister
Northwest Territories Power Corporation	March 31, 1989	Minister
Northwest Territories Liquor Commission	March 31, 1989	Minister
Legislative Assembly Retiring Allowances Fund	March 31, 1989	Chairman, Management and Services Board
Arctic College	March 31, 1989	Minister
Petroleum Products Revolving Fund	March 31, 1989	Minister

The audit staff was given full access to all vouchers, records, documents and files and was provided with all explanations and information requested during the audit of the above accounts. We thank the staff of departments and agencies for their cooperation.

This report is a part of the Auditor General's Report on the 1989 financial statements of the Government of the Northwest Territories, as required by Section 30 of the Northwest Territories Act. The Act requires the Auditor General to provide a report on "other matters" within his audit scope that he feels should be brought to the attention of the Legislative Assembly. Accordingly, we report the following items of concern, along with our recommendations and management's responses. While we consider these items are of interest to Members of the Legislative Assembly, they are not, individually or collectively, sufficiently material to require a reservation of opinion in the Auditor General's report on the Government's 1989 financial statements.

Chapter 1

Cases of Non-Compliance with Acts

1.1 Department of Finance

Issue:

The Financial Administration Act (FAA) requires that departments control their expenditures at the activity level. This was not done effectively in six departments during the fiscal year 1988-89.

Facts:

Section 32(1) of the FAA states "... no person shall incur any expenditure that causes the amount of the activity set out in the Estimates upon which the appropriation is based to be exceeded." It is the responsibility of departmental managers to prevent overexpenditures.

Six activities totalling $3.3 million were overexpended in 1988-89. Table 1 provides details.

For comparison, in 1987-88, 20 activities totalling $2.2 million were overexpended. Table 2 compares overexpenditures for the two years.

Discussion:

Assessing the Problem

We made a similar observation last year (for 1987-88) which was the first year that departments had to control expenditures at the activity level. Previously, departments only had to control expenditures to the department level.

Each department's operations are made up of one or more activities. Expenditures are made through either operations and maintenance or capital votes.

To illustrate, the Department of Health has five operations and maintenance activities:

Territorial Health Insurance Services
Medicare
Medical Transportation
Administration
Supplementary Health Programs

The FAA requires the Department to control its expenditures at these levels, yet as can be seen from the following table, two of them were overspent.

TABLE 1

Schedule of 1988-89 Overexpenditures

Operations and Maintenance

	$	% of budget
Finance		
Debt Financing	$ 582	-
Personnel		
Regional Operations	485,719	2.7
Health		
Territorial Hospital Insurance Services	1,722,300	1.9
Medical Transportation	626,147	4.5
Social Services		
Corrections Services	188,011	1.2
Family & Children's Services	288,282	3.2
Total Activities Overexpended	$ 3,311,041	0.4

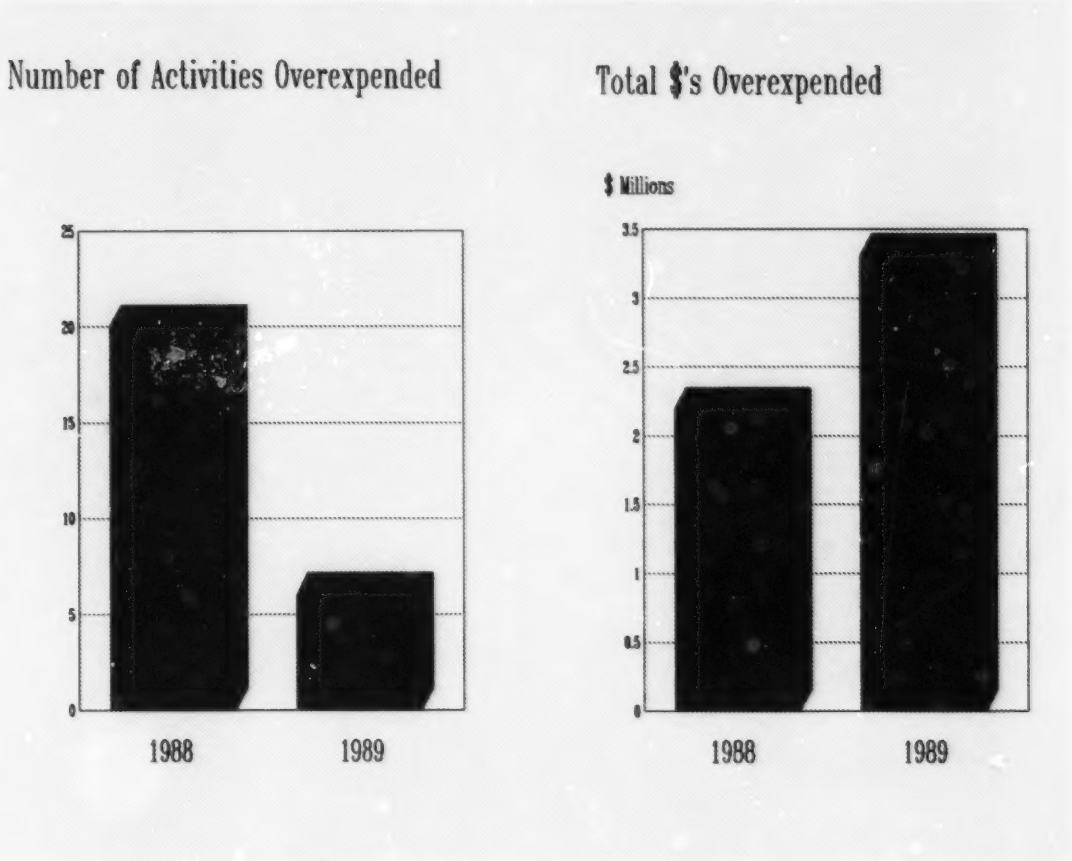
It is possible for a department to overexpend an activity and still not overexpend the entire department's vote. This can occur if other activities in the same vote are underexpended by a greater amount.

In 1988-89 only the Department of Personnel overexpended in total. Personnel overexpended its Operations and Maintenance vote at the departmental level by $394,000. This was in spite of receiving a supplementary appropriations of some $2 million during the year. This was the first time since 1982-83 that a department had overexpended in total.

Last year management of the Department of Finance responded that since 1987-88 was the first year of the new requirement, they expected some transitional problems such as overexpenditures. Table 2 shows that the problem still exists.

TABLE 2

Comparison of Overexpenditures Between Years



Most of the overexpenditures at the activity level are in non-discretionary areas where overexpenditures are often outside of a department's direct control.

> For example, Health's Medical Transportation costs are overexpended. These costs are driven by doctors' decisions to transport patients needing better treatment than may be available at the diagnosis location. If the number of these decisions exceed those anticipated and budgeted by the Department, the activity budget will be exceeded.

The Legislative Assembly passed the FAA prohibiting overexpenditures at the activity level. If departments have acceptable financial management and control systems, they should know when they are running into overexpenditure situations and notify the Financial Management Board in sufficient time to justify a transfer from another activity or a supplementary estimate.

Finding Solutions

During the current year's audit, we noted that managers are still not recording their commitments fully with the result that overexpenditure reports cannot be effective. Managers lack the information they need to avoid violating the FAA by committing expenditures without knowing whether funds are available.

Last year we noted that the Government's computer system is set up to reject certain types of payments. We recommended that this be changed to stop the production of cheques where these would cause an overexpenditure.

The Department of Finance rejected this recommendation. Instead, it reminded departments of their responsibility to control expenditures. In early 1989, it started giving departments a new monthly computer report designed to warn managers when they have overexpended or are about to overexpend.

If this report is to be successful in helping to prevent overexpenditures, it should include all known and contracted costs. We noted that departments do not always record (or "commit") expenditures in the Government's computer system. To know where they stand, managers should record expenditures when they are contracted. If this is done, departments will know how much of their budgets are left. If they don't, departments risk finding out about overexpenditures only when cheques are issued. Managers can use the computer system to record their departmental commitments, but they don't always do it.

Recommendations:

The Department of Finance should introduce government-wide controls to prevent budgets at the activity or departmental levels from being exceeded. These should be designed to:

- **Prevent overexpenditures, and**

- **Hold managers accountable for any overexpenditures which they incur.**

Management Response:

1987-88 was the first year of legislative control at the activity level. In that year there were 20 activities overspent. Management took steps to reduce the incidence of activity overexpenditures. These measures have been successful as the number of activity overexpenditures in 1988-89 was reduced to 6.

The activities overexpended in 1988-89 were in non-discretionary areas where managers have limited ability to control the level of expenditures, and forecasting is particularly difficult. With the Government's tight budgetary practices, departments have little flexibility to absorb unanticipated expenditures in non-discretionary areas.

The institution of further computerized controls at the activity level, or the adoption of less restrictive budgetary practices will not prevent activity overexpenditures, and may only lead to other management problems. It is perhaps more appropriate to consider these activity overexpenditures as exception situations signalling a need for corrective action. We will undertake to work with the Office of the Auditor General and the Standing Committee on Finance to investigate options to deal with this matter.

1.2 Department of Finance

Issue:

The Financial Adminstration Act provides for the use of a Special Warrant to authorize the expenditure of urgently required money. The Department of Finance used a $4,522,000 Special Warrant in a situation where it could have used a Supplementary Appropriation.

Facts:

Special Warrants bypass parliamentary control over the public purse, so the Act puts restrictions on their use.

The Department of Finance obtained the Special Warrant in December 1988. It used this money to pay interest on debt of $53.5 million incurred to finance the acquisition of Northern Canada Power Commission from the federal government.

The financing arrangements were finalized in June of 1988.

Discussion:

The amount of the interest expense was known in June 1988. There was sufficient time to include it in Supplementary Appropriation Act No. 2 (1988-89) tabled in the fall of 1988.

If this had been done, the Legislative Assembly could have discussed and approved the expenditure. The December 1988 Special Warrant would not have been necessary.

Retroactively this amount was included in Supplementary Appropriation Act No. 3 (1988-89), and approved in the spring of 1989.

Recommendation:

Special Warrants should not be used in cases where sufficient time is available to include the expenditure in an appropriation act.

Management Response:

Agreed. The case cited arose because of a departmental oversight. A supplementary appropriation should have been sought earlier in the process.

1.3 Department of Health

Issue:

The Territorial Hospital Insurance Board has not prepared annual reports as required by the Financial Administration Act.

Facts:

Both the FAA and the Territorial Hospital Insurance Act require the Territorial Hospital Insurance Board to prepare annual reports and submit them to the Minister responsible. Management indicates that the last annual report was prepared for 1983-84.

Discussion:

Producing annual reports is important. They are one way for Boards to be accountable to the Minister.

Management informs us that they are preparing a single 5 year annual report to catch up with reporting.

Recommendations:

Management should prepare and submit annual reports as required by Legislation.

Management Response:

The Department of Health is preparing and intends to table a consolidated 5 year annual report in the upcoming winter session of the Legislative Assembly.

Chapter 2

Financial Impact of Devolution from Canada

Department of Finance

2.1 Introduction

The Government is assuming responsibility over a number of areas which, until recently, were under the jurisdiction of the federal government.

It is essential that the Legislative Assembly is provided with accurate information on the programs transferred, including the ongoing costs and the level of service provided to users.

Table 3 lists some significant programs recently devolved from Canada:

TABLE 3

Major Programs recently transferred from Canada

Program	Year Transferred	Approximate Amount Transferred
Baffin Hospital	1982	$ 3,120,000
Highway Reconstruction	1985	5,723,000
Baffin Health Services I	1986	3,824,000
Fire and Forest Management	1987	24,087,000
Baffin Health Services II	1987	3,019,000
Northern Canada Power Commission	1988	--
Remaining Nursing Stations and Health Care in the NWT	1988	49,350,000

We reviewed financial aspects of three of these transfers. The results of our review follow.

2.2 Cases Examined

Issue:

Devolution of Programs from Canada is a step in NWT constitutional development. However, there are financial aspects that the Government should be aware of in negotiating future transfers.

Facts:

We reviewed financial aspects of three programs devolved from Canada to determine whether problems occurred, and how the Government addressed them:

Case 1 - 1986 Transfer of Baffin Health Care Responsibilities from Canada

We reviewed an internal audit report prepared by the Territorial Audit Bureau (TAB), and discussed it with managers from the Department of Health.

The report concludes that the federal government transferred adequate resources to operate health care in the Baffin at existing levels of service. However, several new positions have been created since the transfer. These will have a net incremental cost to the Government of $350,000 annually. There is no provision to recover these additional costs from the federal government.

Department of Health Comment:

It would be unreasonable to expect that the staffing situation in Baffin would remain static. The increased cost was borne from within available GNWT funding and this was handled in a fully responsible manner. There is and was no need to recover these costs from Canada through a special arrangement as the Government's global financial needs are primarily addressed through the Formula Financing Agreement.

Case 2 - Transfer of Remainder of Health Care Responsibilities from Canada

There was an unusual pay issue outstanding between the federal government and the nurses' union around the time of this transfer. At the time, all parties expected this to result in a large one time increase to nurse's salaries, and an additional annual increase.

The new salaries were not known at the time of the transfer, so the transfer agreement used the existing nurses' salaries to calculate the money transferred. The agreement between the federal government and the Government made it clear that the GNWT is responsible for all future wage increases. However, around the time of the transfer, Health and Welfare Canada indicated that it would support a further increase in funds to cover these salary increases. It also indicated that any additional funds for this one time salary increase would have to be recommended by the Department of Indian Affairs and Northern Development, and approved by federal Treasury Board.

Each nurse received a lump sum payment of $5,500, and an annual increase. At this time, management has not calculated the total of these costs. Negotiations continue as to whether the federal government will compensate the Government for these additional costs.

Department of Health Comment:

At the present time a Treasury Board Submission to address the first pay equity adjustment is pending and a further submission will be made to cover other anticipated adjustments agreed to at the time of transfer.

Case 3 - Transfer of Fire and Forest Management from Canada

Fluctuating Costs

Table 3 above indicates that a total of $24,087,000 was transferred to the Government for Fire and Forest Management. Of this, $17,326,000 relates directly to fire fighting. This amount is a statistical estimate of average fire fighting costs.

Analysis of the financial impact of this transfer is complex, because the cost of fighting fires changes from year to year. For example, the 1989 fire year was one of the worst on record, and the Government spent some $27 million on fire fighting. But 1988 was one of the lowest, and it spent only $17 million.

In the three years to 1990, if the cumulative costs of fighting fires are higher than the three year funding transferred under the agreement, the Government can recover the excess costs over one million dollars. After 1990, the Government bears all the risk of fluctuating fire fighting costs.

Costs Higher Than in Agreement

Another issue in this transfer is whether the $24,087,000 transferred from the federal government is in fact adequate to cover fully the Government's costs.

The Department of Renewable Resources noted that the cost of its employee salaries and benefits is higher than the federal government's cost. Yet the money transferred is based on the federal government's cost, not the Department's. For example, at the time of the transfer the Government provided a housing allowance to employees while the federal government did not. The $24,087,000 transferred does not include an amount for housing allowances, yet the Government's policy is to pay them.

The Department estimates that the funding transferred from the federal government for salaries and benefits is less than the Government's actual cost by $450,000 per year in 87/88 dollars.

Discussion:

The above 3 cases show various financial risks of devolution.

First, there is a risk that the additional money that the federal government gives to pay for a transferred program will be inadequate. When this happens, the Government must either pay for the shortfall with its own money or cut back services, if it can.

Second, when a program is transferred, the Government assumes the responsibility for the cost of future program improvements, and the savings from any program reductions or efficiencies. The Formula Financing Agreement with the federal government increases the grant annually based on the growth of other government expenditures in Canada. If the Government's actual costs rise by more than the increases in the grant, it will have to pay for the shortfall itself.

> For example, as new medical procedures are developed, hospitals adopt this new technology. None of the three transfer agreements we reviewed allow the Government to obtain increased funding from the federal government to pay for future program changes. If future changes cost more than the annual increase in the Formula Financing Agreement, the Government will have to find the additional money from its own budget or rely on the goodwill of the federal government to fund them, an unlikely option with current spending cut-backs.

Finally, unlike other governments which can raise taxes to pay for program cost increases, the Government is dependent on the federal government for 85 percent of its revenues. If the federal government does not continue funding at this level, the Government must either increase its own revenues or cut services.

Recommendation:

In negotiating future program transfers, for example, inter provincial/territorial highways and class B & C airports, the Government should ensure that all future costs are known, and that its financial interests are protected.

Management Response:

The Government has clear policy guidelines respecting program transfers which are embodied in the Devolution Policy. Principle 6 of the Devolution Policy states:

"That the basis for calculating resources to be transferred should be GNWT program needs."

The Devolution Policy establishes clear and thorough procedures for undertaking program transfer negotiations. These procedures, when followed, will ensure that all relevant issues and risks are identified. Regardless of how thorough and competent the Government's approach to program transfer negotiations, the transfers involve risk.

Through devolution the Government is receiving authority over future program direction, and accepting responsibility for future cost escalation. The potential for subsequent overall funding reductions being unilaterally imposed by Canada is also a risk associated with accepting program transfers.

Chapter 3

Department of Economic Development and Tourism

3.1 Departmental Overview

The Government established the Department of Economic Development and Tourism to promote business development in the NWT to increase income and employment opportunities for Northerners.

There are two main activities within the Department: Business Development and Tourism & Parks.

Business Development provides technical and management assistance to businesses. It does this through the provision of services to clients and through departmental grant and contribution programs and joint federal/territorial programs such as Special ARDA and the Economic Development Agreement. The Department provides Loans and guarantees through the Business, and Eskimo Loan Funds.

The Government established the Business Loans and Guarantees Fund (BLGF) to provide direct loans to businesses or guarantees to financial institutions. The authorized Fund limit for 1988-89 is $16 million.

Tourism & Parks develops and markets tourism resources and products. It does this through the provision of services to clients and through departmental grant and contribution programs and the tourism subagreement of the federal/territorial Economic Development Agreement.

The BLGF advances are not charged to the department's budget, but to the Fund established by the Legislature. Charges to the Department's budget are for bad debts only. Since loan advances are non-budgetary, they are not included in the Government's expenditures in its financial statements (Section II of the Public Accounts).

The BLGF loan advances are similar in intent to the Department's Grants & Contributions. Both are risky payments intended to develop the NWT economy. Both require the skill and judgement of management to determine which businesses receive aid, and which do not.

The major difference is that while recipients of Grants & Contributions seldom repay them to the Department, the Department expects repayment of BLGF loans.

3.2 Business Loans and Guarantees Fund

Over the past three years, we have dealt extensively with the BLGF in our Reports to the Legislative Assembly. We noted a general improvement in the administration of the Fund but some problems still exist.

This year our review of the BLGF disclosed the following matters which we feel should be brought to the attention of the Legislative Assembly:

3.2.1 Write-offs versus Forgiveness of Debts

Issue:

The Financial Adminstration Act (FAA) distinguishes between "Write-Offs" and "Forgiveness" of debts. The Department does not recognize this distinction when it seeks Legislative Assembly approval for action.

Facts:

Sections 24 and 25 of the FAA deal with write-offs and forgiveness. The difference is:

- A write-off is an accounting entry to remove an old debt from the accounts. This does not imply that the Government will stop actively pursuing collection of the debt.
- Forgiveness implies that the Government no longer intends to pursue collection of this debt, even if (now or in the future) collection is possible.

During our examination, we found the following two examples of debts recommended for write-off:

Case 1

A loan of more than $300,000 was recommended for write-off. The Department does not intend to pursue future recovery of this debt, because of debt restructuring arrangements made with the federal government.

Case 2

A loan of more than $40,000 was recommended for write-off. The Department has instructed its lawyers not to pursue the personal assets of the principals for collection of this debt.

Discussion:

It's important to inform the Legislative Assembly whether debts are recommended for write-off or forgiveness. Each has significantly different implications.

Each of the above cases appears to be examples of forgiveness. Yet, they were recommended to the Assembly only as write-offs. As a consequence the Assembly would expect further collection efforts.

Recommendation:

Debt action recommended to the Legislative Assembly should be classified properly as either for write-off or forgiveness.

Management Response:

The Department recognizes and acknowledges the difference between write-off and forgiveness of debts. In future, the Department will recommend the appropriate action in submissions to the Legislative Assembly.

3.2.2 Realization on Personal Guarantees

Issue:

The Fund has a poor record collecting Personal Guarantees on default of BLGF Loans.

Facts:

Lenders normally help secure a loan by taking personal guarantees from business principals.

The Fund managers noted the importance of Personal Guarantees in their comments included in our 1988 Report.

We reviewed the Fund's collection experience on guarantees. Collections on guarantees are rare. The Fund's Managers confirmed this finding.

Discussion:

Clearly the aims of a private lending institution and the BLGF are different. After default, private lenders aggressively pursue personal guarantees. In the BLGF, management may feel that aggressive enforcement is unfair in some cases.

This issue relates to write-offs versus forgiveness. Unless the Fund obtains the Legislative Assembly's permission not to pursue personal guarantees, the FAA obligates the Fund to pursue them.

Recommendation:

The Fund should pursue collection of personal guarantees, except in those cases where the Legislative Assembly directs otherwise through a Forgiveness Act.

Management Response:

The Department acknowledges that the track record on recovery of personal guarantees has met with little success. The primary reason is the financial status of the clients we deal with as a lender of last resort.

Since the act of recovery on a bad debt requires the cooperation of this Department, the Department of Finance and the Department of Justice, we will meet with our respective counterparts to determine what improvements can be made in this area.

3.2.3 Relations with Other Lenders

Issue:

The BLGF does not aggressively pursue its rights when dealing with other lenders.

Facts:

During our audit, we noted the following 3 examples of the Fund's dealings with other lenders:

Case 1

As discussed at page 24, a borrower constructed an addition to its financed property without first informing the Fund.

Additional financing for the expansion was needed. The BLGF and another lender each made new loans to the business. The BLGF allowed the other lender to share the Fund's security, which diminished to 58 percent from 100 percent of the total.

In this case, the Fund made the best of a bad situation. One way or another, the business needed money.

Case 2

The BLGF held first security on loans of $89,000, where the business went into receivership. Despite this, the Fund allowed another lender to share in the proceeds, without getting anything in return.

As a result, the Fund's managers expect to write-off approximately $47,000.

Case 3

A bank held first security on a business which went into receivership. The Fund held second security on its loan of $50,000.

The bank acted as a lender normally would, and used its legal right to recover all its outstanding loan before the BLGF received any money. The Fund received $5.35.

Discussion:

These three cases show the range and complexity of dealing with other lenders.

In the first case, the borrower did not inform the Fund of the planned expansion because the loan agreement did not require it. When the Fund lent the business additional money, it amended the loan agreement. Now the borrower must obtain the Fund's prior permission for any expansion.

The second case occurred in 1987. The Fund's Managers shared the proceeds because they felt that the other lender did more work to wind up the business than the Fund.

Sharing proceeds has serious implications for both the Fund, and financial management by the GNWT. Sharing proceeds is a grant to the other lender. Normally grants are approved by the Legislative Assembly.

At times, the BLGF acts as a lender of last resort. It accepts lesser security because other lenders have a priority interest. The third case illustrates the vulnerability of the Fund in these situations.

Recommendations:

1. **All Loan Agreements should include provisions that prohibit the borrower from doing things which could hurt the Fund's interests without written approval. This should include a prohibition on any expansion without approval.**

2. **The BLGF should aggressively pursue its rights with other lenders when loans are in default.**

Management Response:

The Department acknowledges that there have been cases where our negotiations with other creditors may not have produced optimum results.

With respect to Case #1, there is now a clause in our Letter of Offer which obliges the borrower to inform us when an expansion is planned which will have a direct and material impact on our security.

Pertaining to Case #2, the Department received what was considered to be fair value for our first position ($50,000.00) and an equitable share on the remaining assets on which we were in second position, [50% of the proceeds after tax and costs ($4,500.00)].

In Case #3, the proceeds from the sale of security were insufficient to cover the outstanding debt.

In summary, it is recognized that every effort should be made to protect the Fund's interest when negotiating with other creditors and our client group.

Chapter 4

Items reported in previous years

4.1 Department of Finance

4.1.1

The Financial Administration Act (FAA) requires that the Government control expenditures at the activity level. This is not being done effectively.

We discuss this issue at page 2 of this report.

4.1.2

Departments are continuing to make payments exceeding activity budgets, on the assumption that the Financial Management Board will approve transfers to cover the deficit.

Last Year's Observation

Section 32 of the Financial Administration Act (FAA) requires that funds be available in an activity before a commitment is made. The FAA allows the transfer of budgets between activities. However, departments request activity transfers near year end to avoid overexpending activity budgets.

Current Year's Followup

This year we observed that departments requested transfers late in the fiscal year. When these transfers are approved after the expenditures have already occurred, the only purpose they serve is to reduce the number of activities reported as overexpended.

If departments spend money before they request transfers, then transfers merely make them look better by eliminating overexpenditures. The FAA prohibits spending more money than is currently available.

The issue of late transfers is closely related to our discussion this year of overexpenditures. Both are symptoms of the same problem. Overexpenditures are discussed at page 2 of this report.

4.1.3

Tax Rebates to a NWT utility are not passed on to consumers.

Last Year's Observation

Under a federal Act, the federal government rebates to the NWT 95% of taxes collected from two domestic utilities. The Government of the Northwest Territories rebates this money to the utilities on the understanding that they will pass the benefits back to their customers. In 1988 we noted that one of the utilities still held $415,000 in tax rebates which it had not passed back to customers.

Current Year Follow-up

The Department of Finance, with the approval of the Financial Management Board, has instructed the utility to rebate the undistributed surplus evenly over the year 1989-90.

In addition, the Department has requested a new Regulation to govern these rebates.

4.2 Department of Social Services

4.2.1

In 1987-88 the Department forgave $11,000 of minor social assistance overpayments without the required approval of the Legislative Assembly.

Last Year's Observation

Last year we noted that the Department forgives minor social assistance overpayments without the approval of the Legislative Assembly. The Financial Administration Act (FAA) does not permit this unless the Social Assistance Act states that it overrules the FAA. To solve this problem we recommended an amendment to the Social Assistance Act to exempt forgiveness of minor overpayments from the provisions of the FAA.

Current Year's Followup

The Department's Management indicates it has drafted legislation exempting forgiveness of overpayments from the provisions of the FAA. It is currently being cleared with other Departments. If this legislation is submitted to the Assembly and approved by it, this problem will be corrected.

4.2.2

Failure to follow an agreement with the federal government has cost the Government $800,000 more than necessary to finance the Young Offenders Program.

Last Year's Observation

The Department of Social Services bills the federal government for the federal share of the cost of the Young Offenders Program. In 1988 we reported that delays in these billings had cost the Government more than $800,000 in lost interest revenue. Last year the Department indicated that the federal government owed it $6.7 million for Operations and Maintenance costs under the program.

Current Year Followup

During this year, the Department hired a new claims officer to work on the billings. However, since time is required to clear the backlog we estimate that some $700,000 in interest revenue was lost during the year. Management indicates this amount will decrease even further in future years. With the new person, the Department is making progress in finalizing old claims and preparing new ones:

Operations and Maintenance Costs

Balance as at March 31, 1988	$ 6,700,000
Add:	
Revisions to old interim billings	1,100,000
1988/89 billing	3,500,000
	11,300,000
Less:	
Cash received in 1988/89	3,100,000
Amount still owing to the Government as at March 31, 1989	$ 8,200,000

The Department notes that it received $4.8 million of this amount in July 1989.

4.2.3

Financial controls over payments to beneficiaries of social assistance programs are inadequate.

Last Year's Observation

Last year we noted that the Government pays out more than $18 million in social assistance payments annually. The controls over these payments were inadequate. Some of the problems we found included only one person approving payments, and the issuing of multiple cheques to avoid a limit of $1,000 per cheque.

Current Year Followup

The Department's Management indicates that they are working on correcting these problems. They do not expect final resolution for some time. This is because some of the corrections anticipated involve changes to forms and computer programs, and the involvement of other departments.

In the interim, the Department directed supervisors to review batches of payment documents after payment has been made. Although this procedure will not prevent a fraud or error, it may detect problems and allow corrective action to prevent them from occurring in the future.

4.3 Department of Education

4.3.1

Funding arrangements for Arctic College are being made without appropriate financial controls, resulting in weakened financial management.

Last Year's Observation

In 1988 we reported that the funding agreement between the Department of Education and Arctic College should have matched the timing of the College's receipts and payments. Last year the College received its contributions from the Government well in advance of expenses. As a result, the College earned over $800,000 in interest revenue.

Current Year Follow-up

We noted that this year Arctic College earned interest revenue of more than $900,000. This was expected, as there was insufficient time to make the changes needed.

The Department of Education has raised this issue with the Financial Management Board. Instead of dealing with this issue in isolation, the Department intends to totally re-evaluate funding for both Arctic College and schools. It plans to implement changes to funding for the 1991-92 fiscal year.

This plan will delay a solution to this problem for at least a further two years.

4.4 Department of Municipal and Community Affairs

4.4.1

The Government is carrying on its books a receivable from the federal government of $411,451 for grants in lieu of taxes which the federal Department of Public Works disputes.

Last Year's Observation

Last year we noted that the Government is carrying a large receivable from the federal government for grants in lieu of taxes. The total receivable was some $793,846. The Government has provided for $382,395 as uncollectible but still shows $411,451 as receivable.

Current Year Followup

During the Public Accounts Committee hearing in the spring of 1989, the Department's management indicated that they expect to resolve this issue during the year. As of November 1989, management indicates that negotiations are still in progress at the ministerial level. No solution has yet been reached.

Management Response:

The Department has continued to actively pursue collection of this long outstanding account. In November 1989, the Government Leader wrote to the Minister of Indian Affairs and Northern Development seeking meetings to resolve the issue. To date no reply has been received.

The Department has asked the Department of Finance to take action on this matter since the responsibility for property tax collection and collection of overdue accounts was transferred to them.

4.5 Department of Economic Development and Tourism

4.5.1

An important rule in the Business Loans and Guarantees Fund Act was not followed.

Last Year's Observation

In 1988 we reported that the Department did not follow an important rule in the Business Loans and Guarantees Fund Act. The Act requires that loans cannot normally exceed 10 times the amount of the applicant's equity.

The Act indicates that this rule can be waived, but only if the Loan Board feels special circumstances exist.

We found one case where the loan exceeded 10 times the amount of equity, but no special circumstances were shown.

Current Year Follow-up

During the current year's audit, we noted 2 cases where a loan exceeded 10 times equity. In both cases, Loan Board minutes documented the special circumstances adequately.

This suggests that the Department is now documenting special circumstances as required by the rules.

4.5.2

Government Loans are put at risk where shareholders can withdraw their investment before repaying the loans.

Last Year's Observation

Usually loan agreements limit the amount of cash that shareholders can take out of a business before the business repays its loans. This prevents shareholders from "stripping" money out of the business and leaving insufficient funds to repay the loan.

In 1988 we noted one case where there was some evidence that cash was withdrawn from a business by shareholders before the business repaid a loan to the Fund. At the time of our audit, it was not clear what investigations were made by Fund staff.

Current Year Follow-up

In 1989 the Department has included a restriction on shareholder cash withdrawals in the Fund's standard letter of offer.

We did not find any other cases of excessive cash withdrawals during our current year's audit.

4.5.3

A significant condition affecting an applicant's future viability was not confirmed and adjusted before approving a loan for $150,000.

Last Year's Observation

Last year's observation centred on the risk of transactions not at commercial values between connected parties.

Whenever related parties conduct business, the Fund should review the transactions to determine whether they are at market value, or at some other value. Transactions at non-market value can be used to make one of the businesses look more successful before applying to the Fund for a Loan.

During last year's audit, we found one example of this.

Current Year's Follow-up

During the current year's audit, we did not find any new examples of transactions between connected parties at other than market value.

The loan from last year was current as of June, 1989.

Last year, management noted that they use personal guarantees as a safeguard against transactions between connected parties at special values. This year, all new loans we reviewed had personal guarantees in place. However, this year we reviewed the value of personal guarantees as security. We discuss the results of this review at page 14.

4.5.4

A key business success feature was not included as a condition of a loan approval of $400,000.

Last Year's Observation

In 1988 we reported where the Department's own analysis of a loan application indicated that a management contract to operate the business was key to its success. However, the management contract was not signed until after the Fund made the $400,000 loan.

This put the Department at risk. Problems could occur if:

- the contract arrangements fell through, or
- the business lacked proper management, or
- if the management fees in the contract were excessive.

Current Year's Follow-up

As of June 1989, this loan is current. However, we noted one item of concern with this loan:

The original loan agreement did not prevent the business from starting any major construction without the Fund's permission. Since the original loan, the business expanded without notifying or requesting permission from the Fund's managers. This put the Fund in an awkward position. We discuss this further at page 16.

4.5.5

An important condition omitted from a letter of offer on a loan for $300,000 was not discovered by the program staff.

Last Year's Observation

In 1988 we reported that the Loan Board required a particular applicant to get at least 50 shareholders with total equity of $50,000 before a loan would be issued. However, the letter of offer did not include this condition. The Department made the loan for $300,000 even though the Board's requirement was not met.

Current Year's Follow-up

Since the letter of offer did not contain this condition, there is no legal way of enforcing it after the fact. So, this year the Department obtained the Loan Board's approval to delete this condition.

This resolved the documentation on this particular case, but not the fundamental reason for requiring this condition in the first place.

For the future, the broader issue is ensuring that all letters of offer contain all conditions required by the Board.

Management indicates that letters of offer are now double checked to help prevent errors in the future.

During the current year, we observed no cases where the Department failed to include Loan Board conditions in letters of offer.

4.5.6

A venture capital contribution of $150,000 advanced to an applicant in March 1987 was still not invested in an eligible project as of July 1988.

Last Year's Observation

Last year we noted where $150,000 had been deposited in a bank trust account for over 15 months. Program rules require applicants to use advances within one year, or repay the advance.

Current Year's Follow-up

This year we noted that the $150,000 and interest was repaid to the Program.

4.5.7

1987 - Use of Specialists for Business Evaluations

Prior Year's Observation

In 1987 we reported that the Department did not have clear policies in place to determine when and how specialists should be used to help evaluate loan applications.

As a result of this lack of a policy, the Fund made a loan to a business proposing a new industry for the Northwest Territories. The business had operating problems later, and went into receivership.

1988 Follow-up

In 1988, we noted that the Department developed an adequate policy on the use of specialists. We did not find any cases where we felt that a specialist should have been used, and was not.

Current Year's Follow-up

Similarly, during 1989, we did not note any cases where we felt that a specialist should have been used, and was not.

However, we noted that as of March 31, 1989, the BLGF still showed a receivable of over $130,000 from the business. The fund considers the entire amount uncollectible.